No. 17-494

IN THE
Supreme Court of the United States

SOUTH DAKOTA.,
Petitioner,
v.
WAYFAIR, INC., ET AL.,
Respondent.

On Writ of Certiorari to the Supreme Court of South Dakota

BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

INTEREST OF *AMICUS CURIAE*[1]

The Tax Foundation submits this brief as *amicus curiae* in support of neither party in the above-

[1] Pursuant to Supreme Court Rule 37.6, counsel for *Amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *Amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *Amicus* represents that all parties were provided notice of *Amicus's* intention to file this brief on February 16, 2018. Letters from the parties consenting to the filing of the brief are filed with the Clerk of the Court.

captioned matter.

The Tax Foundation is a non-partisan, non-profit research organization founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., we seek to make information about government finance more accessible to the general public. Our analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

Because *Amicus* has testified and written extensively on the issues involved in this case, because this Court's decision may be looked to as authority by the many state courts considering this issue, and because any decision will significantly impact taxpayers and state tax administration, *Amicus* has an institutional interest in this Court's ruling.

SUMMARY OF ARGUMENT

This Court should uphold the South Dakota law as a valid enactment without eviscerating the Constitution's limits on state tax power.

The basis for such a ruling should be that state taxation of interstate commerce is constitutionally valid where (1) the state's nexus standard is scaled, with lower state burdens permitting expanded taxation of interstate activity, and vice versa, (2) it is non-discriminatory, neither taxing nor otherwise burdening activity out-of-state while leaving identical activity in-state untaxed or unburdened, and (3) it taxes no more than the state's fair apportioned share of interstate commerce, as measured by internal consistency. In short, this Court should reaffirm its holdings in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

Quill and *National Bellas Hess* used physical presence as a proxy for constitutional nexus, but this has proven both overinclusive and underinclusive. The smallest, most transient, most attenuated physical presence, no matter how burdensome to the economy, subjects economic actors to tax in many states. States that seek to collect sales and use tax on purchases made by their physically present residents, even if done in an unburdensome, non-discriminatory manner that avoids multiple taxation, cannot. And because *Quill* has never been extended to business and income taxes, states and courts have interpreted that as no nexus restraint at all, upholding those taxes on any economic actor.

The result is a situation the Founders sought to prevent: states disrupting interstate commerce with a death by a thousand cuts. This Court will soon be asked over and over and over to consider challenges to a variety of state laws expanding state sales tax authority over interstate commerce. Eighteen states have adopted New York-style click-through nexus sales tax laws, which expand physical presence beyond what this Court described as "the furthest extension" of nexus. Seven states have adopted Colorado-style reporting sales tax laws, which raise First Amendment issues. Three states have adopted economic nexus sales tax laws, which ignore physical presence completely. States may soon consider Massachusetts-style "cookie taxes," which expand state sales tax jurisdiction to essentially any company in the world with a website.

The South Dakota law's nexus standard should be upheld as constitutional because it minimizes the cost of sales tax collection to the extent practicable, by (1)

adhering to interstate standards of sales tax administration, (2) requiring uniformity between state and local sales tax bases, (3) minimizing number of local sales tax rates, which in South Dakota must be either 1 or 2 percent, (4) taxing virtually all final retail transactions under its sales and use tax, without arbitrary exemptions or confusing special tax rates, (5) adopting a meaningful *de minimis* threshold likely to exclude interstate activity where state burdens exceed state benefits, and (6) barring retroactive collection.

We at the Tax Foundation are not a partisan for aggressive or expansive state tax power. Until this case, briefs we have submitted on this issue have always been to urge a ruling against the state. *See, e.g.*, Brief for Tax Foundation as Amicus Curiae Supporting Petitioners, *Overstock.com, Inc. v. N.Y. Dep't of Taxation and Fin., et.al*, 134 S.Ct. 682, 2013 WL 5400248 (Sept. 23, 2013); Brief for Tax Foundation as Amicus Curiae Supporting Petitioners, *Direct Mtkg v. Brohl*, 135 S. Ct. 1124, 2014 WL 6845684 (Sept. 16, 2014). But because the physical presence standard has been almost completely eroded in the last few decades, it is necessary for this Court to resolve an almost universal lack of clarity about the proper scope of state sales taxation of out-of-state entities. We urge the Court to do so, by upholding the South Dakota law at issue here, and adopting a nexus rule that scales state tax authority with the burden placed on interstate commerce.

ARGUMENT

I. A STATE TAX ON INTERSTATE COMMERCE IS CONSTITUTIONALLY VALID ONLY WHERE THE STATE'S NEXUS STANDARD SCALES WITH ITS BURDEN, WHERE THE TAX IS NON-DISCRIMINATORY, AND WHERE THE STATE TAXES ONLY ITS FAIR SHARE OF INTERSTATE COMMERCE.

The people of the United States adopted the Constitution in large part because their existing national government had no power to stop states from imposing trade barriers between each other, to the detriment of the national economy. "[States' power over commerce,] guided by inexperience and jealousy, began to show itself in iniquitous laws and impolitic measures . . ., destructive to the harmony of the States, and fatal to their commercial interests abroad. This was the immediate cause, that led to the forming of a convention." *Gibbons v. Ogden*, 22 U.S. 1, 224 (1824) (Johnson, J., concurring). Consequently, among the powers granted to Congress by the new Constitution was the power "[t]o regulate Commerce . . . among the several States," a provision known as the Commerce Clause. U.S. CONST. art. I, § 8, cl. 3. Congress and the courts thus have the power to strike down laws that discriminate against interstate commerce.

From the Constitutional Convention until the 1950s, states were heavily restricted in their ability to tax individuals, businesses, and sales involving interstate commerce. *See, e.g., Freeman v. Hewitt*, 329 U.S. 249, 252-53 (1946) ("A State is . . . precluded from taking any action which may fairly be deemed to have

the effect of impeding the free flow of trade between States"); *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888) ("No State has the right to lay a tax on interstate commerce in any form.").

In the 1950s, this Court began to ease those restrictions, correctly concluding that involvement in interstate commerce does not completely insulate an individual or business from contributing to providing government services in states where they enjoy the benefits of them. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 284-85 (1977) (comparing *Ry. Express Agency v. Virginia*, 347 U.S. 359 (1954) (*Railway Express I*) and *Ry. Express Agency v. Virginia*, 358 U.S. 434 (1959) (*Railway Express II*)). This Court's *Complete Auto* decision gave a comprehensive and workable list of criteria for determining whether a state's tax law violates constitutional limitations on state tax power: a tax (1) must be "applied to an activity with a substantial nexus with the taxing State," (2) must be "fairly apportioned," (3) must "not discriminate against interstate commerce," and (4) must be "fairly related to the services provided by the State." *Id.* at 279.

The Constitution prohibits state taxes which discriminate against interstate commerce, by taxing or otherwise burdening activity out-of-state while leaving identical activity in-state untaxed or unburdened. *See, e.g., Comptroller of the Treasury of Maryland v. Wynne*, 575 U.S. ____, 135 S.Ct. 1787 (2015) (invalidating Maryland's denial of a full income tax credit for out-of-state investment, where a full credit was provided for in-state investment, using the internal consistency test); *Camps Newfound/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564

(1997) (invalidating Maine's denial of the general charitable deduction to organizations that primarily serve non-Maine residents); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (invalidating a Massachusetts general tax on dairy producers where the revenue was then distributed to domestic dairy producers); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (invalidating an Ohio tax credit to all ethanol producers but disallowed for non-Ohio producers); *Am. Trucking Assns. v. Scheiner*, 483 U.S. 266 (1987) (invalidating a Pennsylvania scheme imposing fees on all trucks while reducing other taxes for trucks in-state only); *Bacchus Imps., Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating a Hawaii tax imposed on a category of products but exempting activity in-state); *Westinghouse Elec. Co. v. Tully*, 466 U.S. 388 (1984) (invalidating a New York scheme exempting activity in-state while simultaneously imposing a tax on identical activity out-of-state); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977) (invalidating a New York tax imposed solely on activity out-of-state while leaving identical activity in-state untaxed). *But see Dep't. of Revenue of Ky. v. Davis*, 553 U.S. 328 (2008) (upholding Kentucky's exclusion from tax of interest earned from its state bonds, but not other states' bonds, on the grounds that Kentucky is acting as a market participant like any other bond issuer).

The Constitution also prohibits state taxes which tax beyond their fair apportioned share of interstate commerce, as measured by the "internal consistency" test of determining if tax burdens would exceed 100 percent if every state adopted the law in question. *See, e.g., Am. Trucking Assns., Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429 (2005) (upholding a fee that

applied only to interstate transactions, after applying the internal consistency test); *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995) (applying internal consistency test to determine Commerce Clause validity); *Tyler Pipe Indus. v. Dep't of Rev. of Washington*, 483 U.S. 232 (1987) (applying the internal consistency test to determine state gross receipts taxes are imposed on wholly intrastate activity); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983) (applying the internal consistency test); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 276 (1978) (upholding Iowa's single-factor apportionment rule against a challenge based on a speculative claim of duplicative taxation); *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256 (1938) (holding that a state's taxation of interstate business "be fairly apportioned to the commerce carried on within the taxing state"); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920) (upholding a single-factor property formula because the only competitive disadvantage from it would be to local businesses). *See also Nw. Airlines v. Minnesota*, 322 U.S. 292, 306 (1944) (Jackson, J., concurring) ("The apportionment theory is a mongrel one, a cross between desire not to interfere with state taxation and desire at the same time not utterly to crush out interstate commerce. It is a practical, but rather illogical, device to prevent duplication of tax burdens . . . .").

Nexus has proven trickier, but this Court has correctly focused on the problematic effects of a sizable compliance or tax burden on interstate commerce. In *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), this Court held that an even-handed state enactment with only incidental effect on interstate commerce is valid unless "the burden imposed on such commerce is

clearly excessive in relation to the putative local benefits." *Id.* at 142. Non-discriminatory, fairly apportioned state enactments have been found invalid in other cases due to excessive burden on interstate commerce. *See, e.g., Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 663 (1981) (invalidating an Iowa law banning 65-foot double tractor trailer trucks as impermissibly burdensome to interstate commerce, after concluding that they were as safe as 55-foot single trucks); *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 524 (1959) (invalidating an Illinois law requiring use of straight mudguards rather than curved mudguards, after concluding that the resultant mudguard changes at the state line would excessively burden interstate commerce); *Southern Pacific Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761 (1945) (invalidating an Arizona law limiting interstate passenger train lengths after determining only one other state had such a law and it therefore impaired interstate commerce). *See also Minnesota v. Clover Leaf Creamery*, 449 U.S. 456, 473 (1981) (upholding a state milk packaging requirement for sales in-state after concluding it was only a minor burden on interstate commerce); *Exxon v. Maryland*, 437 U.S. 117, 127-28 (1978) (upholding a state ban on refiner-owned retail stations after concluding that the loss of three refiners from the state was not an impermissible burden on interstate commerce).

In *Quill v. North Dakota*, 504 U.S. 298 (1992), this Court reaffirmed under the Commerce Clause its rule that a state cannot impose a sales tax collection obligation on a business unless that business is physically present in the state. "Undue burdens on interstate commerce may be avoided . . . by the demarcation of a discrete realm of commercial activity

that is free from interstate taxation. [The physical presence rule] create[s] a safe harbor for vendors whose only connection with customers in the taxing State is by common carrier or the United States mail." *Id.* at 314-15; *see also Nat'l Bellas Hess, Inc. v. Dept. of Rev. of Ill.*, 386 U.S. 753 (1967). While North Dakota in *Quill* had argued that borders are irrelevant in our modern economy, this Court recognized that subjecting non-present businesses to state taxation often means that activity out-of-state is being unconstitutionally taxed. The Court used physical presence as a proxy, but the underlying standard remained evaluating the burden placed on interstate commerce by the state enactment.

Taken together, the Constitution permits state taxation of interstate commerce where (1) the state's nexus standard scales, with lower state burdens permitting expanded taxation of interstate activity, and vice versa, (2) it is non-discriminatory, neither taxing nor otherwise burdening activity out-of-state while leaving identical activity in-state untaxed or unburdened, and (3) it taxes no more than the state's fair apportioned share of interstate commerce, as measured by internal consistency.

II. SOUTH DAKOTA'S LAW IS CONSTITUTIONAL, AS ITS NEXUS STANDARD SCALES WITH THE BURDEN IT IMPOSES, IT IS NON-DISCRIMINATORY, AND IT TAXES ONLY ITS FAIR SHARE OF INTERSTATE COMMERCE.

South Dakota's law minimizes the burden of sales tax collection to the extent practicable, by (1) adhering to interstate standards of sales tax administration, (2) requiring uniformity between state and local sales tax

bases, (3) minimizing number of local sales tax rates, which in South Dakota must be either 1 or 2 percent, (4) taxing virtually all final retail transactions under its sales and use tax, without arbitrary exemptions or confusing special tax rates, (5) adopting a meaningful *de minimis* threshold likely to exclude interstate activity where state burdens exceed state benefits, and (6) barring retroactive collection. In addition, the state does not discriminate against interstate commerce, subjecting out-of-state retailers to the same taxes paid by in-state retailers, and the statute's sales and use tax applies only to South Dakota's fair apportioned share of interstate commerce, purchases made by South Dakota residents not taxed by any other state.

A. South Dakota is One of 23 States with Simplified Sales Tax Collection That Imposes Minimal Burden on Collecting Businesses.

South Dakota is one of 23 states to be a full member of the Streamlined Sales Tax and Use Agreement (SSUTA), a multistate effort to adopt simplified administration and remittances, establish uniform definitions of items subject to tax, and require uniformity between state and local sales tax bases.[2] SSUTA was started in large part as a response to this Court's challenge in *Quill*: to achieve simpler and more uniform state sales taxes whose imposition would not be an impermissible burden on interstate

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[2] The 23 states are Arkansas, Georgia, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, and Wyoming.

commerce. For this reason, SSUTA has been less successful than it could be, due to the non-participation by most states including the large states of Arizona, California, Florida, Illinois, Massachusetts, New York, and Texas. Some states refuse to join to maintain idiosyncratic sales tax practices, such as Maryland's "rounding rule" requiring vendors to round remainders of 4 and above up, rather than the more common practice of only rounding up remainders of 5 and above, or Chicago, Illinois's decision to tax sales of bottled water, soda, non-soda drinks, restaurant meals, candy, and groceries all at different tax rates. *See, e.g.*, Avalara, *How Does Avatax Handle Rounding in Maryland?*, https://goo.gl/YdyA1W; CITY OF CHICAGO, *Tax List*, https://goo.gl/28y3Mj.

It is hard to overstate the hard work and hard decisions that go into being a member of SSUTA. While many states have opted not to undertake this work, and consequently declined to address the issues raised by the Court in *Quill*, South Dakota and its fellow SSUTA members have. While more work can be done, South Dakota's participation in it shows a desire to minimize the interstate tax burden of its sales tax administration and collection mechanisms.

B. South Dakota Requires Uniformity Between State and Local Sales Tax Bases, and Minimizes the Number of Local Sales Tax Rates.

South Dakota permits its municipalities to levy sales taxes, but only by adhering to the state base of transactions and only at uniform rates (either 1 or 2 percent, or 4.5 percent for Indian tribes). *See* SOUTH DAKOTA DEP'T OF REVENUE, *Municipal Tax*

Information Bulletin (Jul. 2017), https://goo.gl/wHCVaB. While most countries have one unified consumption tax for the entire country or for each major region or province, sales taxes in the United States are very decentralized. 38 states authorize local sales taxes with their own rates, and Arizona, Colorado, and Louisiana even permit local sales taxes to have a different base of taxable transactions than the state sales tax. *See* Jared Walczak & Scott Drenkard, *State and Local Sales Tax Rates, Midyear 2017*, TAX FOUNDATION (Jul. 2017), https://goo.gl/UcGQfW.

Nationally there are a total of 10,708 jurisdictions in the United States that impose a sales tax, as of June 30, 2017, ranging by state on the high end from 1,277 in Missouri, 1,153 in Texas, 908 in Iowa, and 800 in Alabama, to just one each in the states of Connecticut, Indiana, Kentucky, Maine, Maryland, Massachusetts, and Michigan. Email from Tricia Schafer-Petrecz, Pub. Relations & Soc. Media Lead, Vertex, Inc., to Joseph Henchman, Exec. Vice President, Tax Foundation. Far from getting fewer, the number of sales tax jurisdictions grows each year, and is up from about 6,000 at the time of the *Quill* decision. South Dakota's decision to require adherence to the state sales tax base, and to establish uniform local tax rates, minimizes sales tax compliance burdens on businesses.

C. South Dakota is One of Three States That Tax Nearly All Services Under Its Sales Tax, Minimizing Complexity and Demonstrating the Statute Has No Discriminatory Intent or Purpose.

Unlike other states that decry the erosion of their

sales tax base while exempting goods and services that total over half their economy, South Dakota taxes it all. Internet sales are the only thing South Dakota does not tax, because they cannot under federal law.

Public finance and economic theory says sales taxes should apply to all final sales of goods and services, and no business inputs. Partly due to historic accident and partly due to policy efforts to exempt some goods, the median state sales tax base covers only 23 percent of final personal income. When states began to levy a sales tax in the 1930s, the tax applied to tangible personal property, items such as clothing, home appliances, and furniture, among other taxable goods. This made the tax relatively easy to administer. It also produced sufficient revenue, as the economy largely consisted of manufacturing and tangible goods. Over time, however, the U.S. economy has changed from a manufacturing-based economy to a service-based economy. Americans are purchasing more services than goods as a percentage of their consumption. In the first quarter of 2017, services accounted for approximately 68 percent of personal consumption expenditures in the United States. *See, e.g.*, Nicole Kaeding, *Sales Tax Base Broadening: Right-Sizing a State Sales Tax*, TAX FOUNDATION (Oct. 2017), https://goo.gl/dYfovD.

Despite the transformation in the economy, states have responded slowly to updating their sales tax bases. The narrow tax bases undermine neutrality, favoring one product or industry over another. While many states decry the forced exclusion of internet sales from their tax bases, they make little effort to address their decision to exclude other goods and services.

South Dakota has chosen not to discriminatorily tax its in-state consumption, instead broadly taxing nearly all categories of transactions under its sales and use tax: South Dakota taxes groceries (taxed in full by only 7 states of the 45 plus the District of Columbia with the tax), clothing (taxed in full by 39 states), non-prescription drugs (taxed by 35 states), personal services such as dry cleaning and haircuts (taxed in full by only 4 states), real estate transactions (taxed by only 3 states), legal transactions (taxed by only 3 states), accounting services (taxed by only 3 states), and even lobbying services (taxed by only 6 states). *See* Jared Walczak, Scott Drenkard, & Joseph Bishop-Henchman, ***2018 State Business Tax Climate Index***, TAX FOUNDATION (Oct. 2017), at 70-72 (complete list by type of transaction and by state), http://www.stateindex.org. South Dakota also relies heavily on its sales tax: in FY 2014, sales tax collections made up 40 percent of South Dakota's state and local revenue, the third highest of any state (behind Washington and Tennessee). *See* TAX FOUNDATION, FACTS & FIGURES 2017: HOW DOES YOUR STATE COMPARE? (table 8), https://goo.gl/AkFKNR. South Dakota has no state individual income or corporate income tax; sales and property taxes are essentially their only taxes and make up three-quarters of total South Dakota state and local tax revenue. *See id.*

These policy choices by South Dakota demonstrate a lack of discriminatory intent or purpose with the law challenged in this case. While many states correctly describe the forced exclusion of internet sales from their sales tax bases as inconsistent with public finance and economic theory, and sound tax policy, they do little to address billions

of dollars of exclusions of goods and services provided primarily by in-state businesses. A hallmark of discrimination under the Commerce Clause is a state taxing or otherwise penalizing activity out-of-state while leaving identical activity in-state untaxed or unpenalized. South Dakota, along with New Mexico and Hawaii, leaves virtually no in-state activity outside its sales tax base. For a clearer consideration of the extent of state tax powers, this Court should decide this statute from South Dakota rather than laws passed in other states that may be less pure in their lack of discriminatory intent or purpose.

D. South Dakota's Law Adopts a Meaningful *De Minimis* Threshold Likely to Exclude Interstate Activity Where State Burdens Exceed State Benefits.

South Dakota's statute minimizes its burden on interstate commerce through establishment of a minimum dollar threshold (of $100,000 in sales) or a minimum number of sales (200). S.D. S.B. 106, § 1. $100,000 or 200 sales in South Dakota, population 865,000, is a lot of sales. This *de minimis* threshold has the effect of excluding those sellers with incidental or purposefully directed sales into the state and where establishing collection mechanisms might outstrip the business's incremental revenue from selling into South Dakota. The inclusion of this provision demonstrates the state's thoughtfulness in preventing unnecessary burdens on interstate commerce associated with its tax collection. If similar provisions were adopted by other states, in proportion to their population or total economy relative to South Dakota's (for example, New York has 22.8 times the population

of South Dakota, so its comparable *de minimis* threshold would be $2.28 million; Massachusetts, with 7.9 times the population of South Dakota, would have a comparable threshold of $787,000 or 4,560 sales), state burdens would be limited to be borne primarily by those enjoying state benefits, comporting with the benefit principle of sound tax policy.

E. South Dakota's Statute Bars Retroactive Collection.

South Dakota's statute also has a provision barring retroactive collection. S.D. S.B. 106 § 5. While this Court has not definitively spoken on the extent of permissible retroactive state tax collection under the Due Process Clause, *compare United States v. Carlton*, 512 U.S. 26, 30 (1994) (upholding retroactive tax laws when "supported by a legitimate legislative purpose furthered by rational means") *with id.* at 38 (O'Connor, J., concurring) ("A period of retroactivity longer than the year preceding the legislative session would raise, in my view, serious constitutional questions.") *and Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (setting out a three-part test on retroactive interpretation of law), numerous precedents, public sentiment, and the principles of sound tax policy look upon retroactive tax collection with disfavor. *See, e.g.*, *Eastern Enters. v. Apfel*, 524 U.S. 498, 547 (1998) (Kennedy, J., concurring in the judgment and dissenting in part) ("If retroactive laws change the legal consequences of transactions long closed, the change can destroy the reasonable certainty and security which are the very objects of property ownership."); *id.* at 558 (Breyer, J., dissenting) ("[A]n unfair retroactive assessment of liability upsets settled expectations, and it thereby undermines a

basic objective of law itself."); *General Motors Corp. v. Romein*, 503 U.S. 181, 192 (1992) ("Retroactive legislation . . . can deprive citizens of legitimate expectations"); Joseph Henchman & Kavya Rajasekar, *The Bounds of Retroactive State Taxes*, TAX FOUNDATION (Feb. 2017), https://goo.gl/7LWSGn; Paul H. Frankel & Amy L. Nogid, *The Manifest Justice to the Manifest Injustice Doctrine: The Time Has Come to Invoke the Ex Post Facto Clause to Bar Retroactive Tax Increases*, Legal Updates & News, Dec. 2008, https://goo.gl/9uZdm3. Indeed, at least one scholar thinks this Court ruled as it did in *Quill* in part because at oral argument in the case, the state's counsel committed to pursuing retroactive tax collection in response to a question from Justice O'Connor. See, e.g., Billy Hamilton, "*Remembrance of Things Not So Past: The Story Behind the Quill Decision*," 59 STATE TAX NOTES 807 (Mar. 14, 2011), https://goo.gl/X7xL1J.

F. South Dakota's Statute Applies Only to South Dakota's Fair Apportioned Share of Interstate Commerce.

South Dakota's sales tax applies only to sales "at retail in the State of South Dakota to consumers or users." S.D. CODIFIED LAWS § 10-45-2. The South Dakota law therefore limits tax liability to those selling to purchasers within South Dakota. *See* S.D. S.B. 106 § 1. If every state adopted South Dakota's law, no purchaser or seller would be taxed more than once. While other proposals such as Massachusetts's cookie tax would subject companies to multiple taxation, the South Dakota law is internally consistent in this regard.

III. WITHOUT THIS COURT'S GUIDANCE, THE STATES WILL BRING ABOUT A COMPLEX PATCHWORK OF TAX LAWS HARMING INTERSTATE COMMERCE, EXACTLY WHAT THE FOUNDERS SOUGHT TO PREVENT.

This Court expressly endorsed the proposition that a state has the power to exercise its taxing authority against an out-of-state vendor if the vendor has a "physical presence" within the state in *National Bellas Hess* and reaffirmed its applicability twenty-five years later in *Quill*. While this Court has acknowledged that an "attributional nexus" standard is the "furthest extension" of nexus, *Quill Corp.*, 504 U.S. at 306, *citing Scripto, Inc. v. Carson*, 362 U.S. 207 (1960); *Tyler Pipe*, 483 U.S. at 250, many states have interpreted this as a floor rather than the ceiling. As a result, many states have enacted legislation that expands nexus beyond *Quill*, including New York-style click-through nexus, Colorado-style reporting and notification, and Massachusetts-style cookie nexus. Further, several states and courts have declined to apply the physical presence standard to business and individual income taxes.

A. 22 States Have Adopted New York-Style Click-Through Nexus Sales Tax Laws, Which Expand Physical Presence Beyond What This Court Described as Its Furthest Extent.

In 2008, New York was the first state to adopt a "click-through" nexus statute. *See* N.Y. TAX LAW § 1101(b)(8)(vi). This statute expanded the definition of nexus to include (as a rebuttable presumption) any out-of-state seller who "enters into an agreement with

a resident of [the state of New York] under which the resident . . . directly or indirectly refers potential customers . . . to seller" and such sales exceeds $10,000 per year. *Id.* This statute was upheld in *Overstock.com, Inc. v. New York State Dep't of Taxation & Fin.*, 987 N.E.2d 621 (N.Y. 2013), finding that contracts with in-state non-employees who refer customers for compensation constitutes substantial nexus. *Id.* at 626 ("Active in-state solicitation that produces a significant amount of revenue qualifies as more than a 'slightest presence' . . .").

Following in New York's footsteps, several other states have enacted similar statutes. *See generally*, BLOOMBERG BNA, *State Tax Snapshot: A Dozen States Say Click-Through Nexus Applies, Despite Absence of Legal Authority*, https://goo.gl/Do5tNx.

- Arkansas in 2011 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* ARK. CODE § 26-52-117(d)-(e).
- California in 2012 adopted a statute with the rebuttable presumption, a $10,000 threshold, and a further requirement that the out-of-state seller have national sales of at least $1 million. *See* CAL. REV. & TAX § 6203(b)(5).
- Colorado in 2014 adopted a statute with the rebuttable presumption and a $50,000 threshold. *See* COLO. REV. STAT. 39-26-102(e).
- Connecticut in 2011 adopted a statute with a $2,000 threshold and no rebuttability. *See* CONN. GEN. STAT. § 12-407(a)(12)(L).
- Georgia in 2012 adopted a statute with the rebuttable presumption and a higher $50,000

threshold. *See* GA. CODE § 48-8-2(8)(M).

- Illinois in 2011 adopted a statute with a $10,000 threshold and no rebuttability. *See* 35 ILL. COMP. STAT. 105/2 & 110/2. *See Performance Marketing Ass'n, Inc. v. Homan*, 998 N.E. 2d. 54 (Ill. 2013) (holding the statute was preempted by federal law and violated the commerce clause of the United States Constitution).
- Kansas in 2013 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* KAN. STAT. § 79-3702(h)(2)(C).
- Louisiana in 2016 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* 2016 LA. H.B. 30, 1st Extra Sess.
- Maine in 2013 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* ME. REV. STAT. tit. 36, § 1754-B(1-A)(C).
- Michigan in 2015 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* MICH. COMP. LAWS § 205.52(b)(3).
- Minnesota in 2013 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* MINN. STAT. § 297A.66(4a).
- Missouri in 2013 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* MO. REV. STAT. § 144.605(2)(e)-(f).
- Nevada in 2015 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* 2015 NEV. A.B. 380.
- New Jersey in 2014 adopted a statute with the

rebuttable presumption and a $10,000 threshold. *See* N.J.S.A § 54:32B-2(i)(1).

- North Carolina in 2009 adopted a statute with the rebuttable presumption language and the $10,000 threshold. *See* N.C. GEN. STAT. § 105.164.8(b)(3).
- Ohio in 2015 adopted a statute with the rebuttable presumption and the $10,000 threshold. *See* OHIO REV. STAT. § 5741.01(I)(2).
- Pennsylvania in 2011 issued a revenue bulletin with no rebuttable presumption and no threshold. *See* Pennsylvania Dep't. of Rev., *Sales and Use Tax Bulletin* 2011-01 (Dec. 1, 2011), http://goo.gl/Dh9Lpf.
- Rhode Island in 2009 adopted a statute with the rebuttable presumption language and a lower $5,000 threshold. *See* R.I. GEN. LAWS § 44-18-15(a)(2).
- Tennessee in 2015 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See* 2015 TENN. H.B. 644.
- Vermont in 2011 adopted a statute with the rebuttable presumption and a $10,000 threshold, with a further requirement that it not take effect until similar legislation passes 15 other states. *See* VT. STAT. tit. 32, § 9783(b)-(c).
- Washington in 2015 adopted a statute with the rebuttable presumption and a $10,000 threshold. *See.* WASH. REV. CODE § 82.08.0521(1).

These statutes create physical presence when a retailer uses an independent contractor even if those contractors do not engage in maintaining an in-state market or a substantial flow of goods. While these

statutes provide for an ability to rebut the presumption that solicitation occurred, rebutting such presumption would inherently be futile, as it is hard to prove what has been done by individuals on the internet. As a result, due to the global nature of the internet, these click-through laws apply more broadly and encompass not only retailers who target sales within a given state, but also retailers who may not actually produce a sale in the given state.

B. Ten States Have Adopted Colorado-Style Reporting Sales Tax Laws, Which Raise First Amendment Issues.

In 2010, Colorado enacted a statute requiring non-collecting retailers to: (1) provide Colorado purchasers a "transactional notice" at the time of purchase, informing them that the purchase may be subject to Colorado's use tax; (2) provide an "annual purchase summary" with the dates, amounts, and categories of purchases of all Colorado purchasers with purchases over $500; and (3) file with the Colorado Department of Revenue an annual report listing their customers' names, addresses, and total purchases. COLO. REV. STAT. § 39-21-112(3.5). The transactional notice and annual consumer report informs Colorado purchasers that they are required to pay taxes, while the annual retailer report assists Colorado in determining the tax liability. In *Direct Mktg Ass'n v. Brohl*, 814 F.3d 1129 (10th Cir. 2016), the Tenth Circuit upheld the Colorado statute after concluding that *Quill's* holding applied to sales and use tax collection and not to the imposition of regulatory requirements.

While the DMA case was presented to this Court on the sole issue of jurisdiction, this Court recognized the potential significance of a ruling upholding the

law. During oral arguments, Justice Scalia stated: "This is certainly a very important case because I have no doubt that if we come out agreeing with [Colorado's State Counsel], every one of the states is going to pass a law like this." Transcript of Record at 24:25-34, *Direct Marketing Association v. Brohl*, --- U.S. ----, 135 S.Ct. 1124 (2015). Justice Alito echoed this conclusion, stating: "If the Colorado law is upheld, as a small internet business, I will have to submit potentially 50 different forms to all of these States reporting that somebody in South Carolina purchased something from me that cost $23.99. . .. [T]hat's where this all could lead, couldn't it?" *Id.* at 32:14-21. Reporting requirements under these notice-and-reporting statutes are deliberately cumbersome so as to compel collection.

Nine other states have these statutes[3]:

- Alabama in 2017 adopted legislation authorizing the Alabama Department of Revenue (DOR) to require non-collecting remote sellers to report Alabama sales to the DOR and notify Alabama customers of their use tax obligations. *See* ALA. CODE § 40-2-11.
- Kentucky in 2013 enacted a statute requiring remote sellers with more than $100,000 in gross sales to Kentucky residents and businesses to provide notice that purchasers must report and pay use tax to the Kentucky Department of Revenue. *See* KY. REV. STAT. § 139.450.

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[3] South Dakota has enacted a less-drastic requirement that sellers notify purchasers, at the time of purchase on their website, that use tax is due. *See* S.D. CODIFIED LAWS § 10-63-2.

- Louisiana in 2016 enacted a statute including all of the provisions contained in the Colorado one. *See* LA. STAT. § 47:309.1.
- Oklahoma in 2016 enacted legislation requiring non-collecting out-of-state sellers to provide each customer with a statement of all sales made. *See* OKLA. STAT. tit. 68, § 1406.1.
- Pennsylvania in 2017 enacted legislation requiring non-collecting retailers who sell at least $10,000 into the state to send written notice listing each purchase made, effective March 1, 2018. *See* PA. CODE § 7213.1.
- Rhode Island in 2017 enacted legislation requiring non-collecting retailers who sell at least $10,000 into the state to send written notice of all purchases, dollar amounts, dates, and types of purchases, to all in-state customers and to provide a list of customers who owe tax to the division of revenue. *See* R.I. GEN. LAWS § 44-18.2-3.
- Tennessee in 2012 enacted legislation requiring non-collecting retailers to provide purchasers with a link to the Department of Revenue's website and to provide each purchaser with an annual statement of sales during the previous calendar year. *See* TENN. CODE § 67-6-515.
- Vermont in 2017 enacted legislation requiring non-collecting retailers who make at least $100,000 in sales to Vermont buyers, or have 200 or more individual sales transactions with Vermont buyers, to send use tax notifications to buyers and to the Vermont Department of Revenue. VT. STAT. tit. 32, § 9712.

- Washington in 2017 enacted legislation requiring "marketplace facilitators" to either (1) register to collect and remit Washington sales tax or (2) comply with Washington's newly-established notice and reporting regime. *See* WASH. REV. CODE § 82-08-052.

These statutes also raise privacy concerns relating to the requirement to notify state officials about what each customer purchases online. A North Carolina revenue ruling similar to the Colorado statute was struck down on these grounds. *See Amazon.com LLC v. Lay*, 758 F. Supp. 2d 1154 (W.D. Wash. 2010). The ACLU joined with Amazon.com to challenge this, noting the danger of unnecessarily requiring disclosure of purchases such as the movie *Lolita* or the book *How to Leave Your Husband*, or even the name of the website as some websites sell embarrassing things. The court held that the First Amendment forbids state tax collectors from knowing what taxpayers are buying. *Id.* at 1170 ("Citizens are entitled to receive information and ideas through books, films and other expressive materials anonymously.").

C. Three States Have Adopted Economic Nexus Sales Tax Provisions Which Ignore Physical Presence Completely.

South Dakota's law has served as the template for laws in Indiana (2017), Maine (2017), North Dakota (2017), Vermont (2016), and Wyoming (2017), with similar thresholds of $100,000 in annual sales or 200 individual transactions in the state. *See* IND. CODE § 6-2.5-2-1; ME. STAT. tit. 36, § 1951-B; N.D. CENT. CODE § 57-40.2-02.3; VT. STAT. tit. 32, § 9701(9)(F); WYO. STAT. § 39-15-501. The Vermont and Wyoming laws

are on hold pending this Court's decision in this case, and the Indiana law is being challenged. *See Am. Catalog Mailers Ass'n v. Krupp*, Ind. Marion Superior Court, Civil Div. 1 (Commercial Court Docket 49D01-1706-PL-025964).

However, three states have adopted more far-reaching abrogation on their tax powers. These regulations require sales tax collection by essentially any economic actor within the state:

- Alabama in 2015 enacted Reg. 810-6-2.90.03, requiring an out-of-state seller to collect and remit sales tax if the vendor has more than $250,000 in Alabama sales and is engaged in an enumerated list of activities. ALA. ADMIN. CODE r. 810-6-2.90.03.
- Mississippi in 2017 enacted a regulation identical to Alabama's. *See* MISS. CODE R. § 35.IV.3.09.
- Tennessee in 2017 enacted a regulation similar to Alabama's, with a $500,000 level of sales, but suspended enforcement pending court challenges. *See* TENN. COMP. R. & REGS. 1320-05-01-.129.

D. States May Soon Consider Massachusetts-Style Cookie Taxes, Which Expand the State's Sales Tax Nexus to All Sellers Everywhere.

On September 22, 2017, Massachusetts proposed Reg. 830, 830 MASS. CODE REGS. 64H.1.7, which would have required vendors with more than $500,000 in sales into Massachusetts from internet transactions and 100 or more transactional sales into the state during the previous twelve months to collect and remit sales and use tax if the vendor: (1) has established a

physical presence through property interests in and/or the use of in-state software (making "apps" available to be downloaded by in-state residents) and ancillary data (placing "cookies" on in-state residents' web browsers), (2) has contracts and/or relationships with content distribution networks, or (3) uses marketplace facilitators and/or delivery companies. Massachusetts subsequently withdrew the regulation but has begun the process of reissuing it. Ohio, however, adopted the standard as law, effective January 1, 2018. *See* OHIO REV. CODE § 5741.01(I)(2)(i). Discussion among state tax administrators suggests other states may consider adopting similar app and cookie nexus provisions.

Under this "cookie nexus" standard, Massachusetts and Ohio have the power to tax any online store on the planet if one of their residents accesses the vendor's website or downloads its app. These "cookie" nexus provisions likely also violate the Internet Tax Freedom Act (ITFA), which prohibits "multiple or discriminatory taxes on electronic commerce." 47 U.S.C. § 151. Advertising in a state has historically not created nexus, or even personal jurisdiction, and the Massachusetts and Ohio provisions create obligations solely for the online equivalent of advertising, cookies and apps. Absent judicial review, many states may follow Massachusetts's and Ohio's lead.

E. Three States Have Concluded that Physical Presence is Inapplicable for Business Taxes, Undermining the Spirit of the *Quill* Decision.

Ohio, Washington, and West Virginia have enacted laws, and courts in those states have upheld them, which impose business taxes without regard to

physical presence.

In 2005, Ohio enacted a "factor presence" law which imposed a tax on any business with at least $500,000 of Ohio gross receipts. OHIO REV. CODE § 5751.01(I). The Ohio Supreme Court concluded that physical presence is a sufficient condition but not a necessary condition when constitutionally imposing business privilege taxes. *See Crutchfield Corp. v. Testa*. No. 2015-0386 (Ohio 2016), 2016 WL 6775765.

Washington imposes a business and occupancy (B&O) tax on the privilege of "engaging in business activities," measured by gross receipts. *See* WASH. REV. CODE § 82.04.220. Washington courts have frequently upheld the application of the tax against businesses with minimal or no physical presence in the state. *See, e.g., Avnet, Inc. v. Dep't of Revenue*, 384 P.3d 571 (Wash. 2016) (applying B&O tax to sales made by an out-of-state company to another out-of-state company if delivery to the ultimate customer is in Washington); *Steven Klein, Inc. v. Dep't of Revenue*, 357 P.3d 59 (Wash. 2015) ("Washington's B&O tax system is extremely broad."); *Simpson Inv. Co. v. Dep't of Revenue*, 3 P.3d 741 (Wash. 2000) (applying B&O tax to receipt of dividends exempt from B&O taxation); *Budget Rent-A-Car of Wash.-Or., Inc. v. Dep't of Revenue*, 500 P.2d 764 (Wash. 1972) (applying B&O tax to casual sales); *Time Oil Co. v. State*, 483 P.2d 628, 630 (Wash. 1971) ("[I]t is obvious that the legislature intended to impose the business and occupation tax upon virtually all business activities carried on within the state.").

In 2005, West Virginia ordered payment of its corporate income tax by credit card companies with customers, but no employees or property, in the state.

The West Virginia Supreme Court found this sufficient for substantial nexus for the tax. *See Tax Comm'r v. MBNA Am. Bank*, 640 S.E.2d 226 (W. Va. 2006). A dissenting judge characterized the decision as "finding tax liability for an out-of-state corporation with no presence, tangible or intangible, in West Virginia on income realized out-of-state by that corporation from accounts kept out-of-state." *Id.* at 236 (Benjamin, J., dissenting).

States increasingly apply business taxes to out-of-state businesses without an in-state physical presence, dragging out-of-state sellers into their taxing regime based on as little as one transaction. *See* BLOOMBERG BNA, SURVEY OF STATE TAX DEPARTMENTS (2017 ed.) (listing various scenarios in which states conclude nexus has been established by non-physically-present businesses); *The Role of Congress in State Taxation: Hearing Before the U.S. House of Representatives Committee on the Judiciary* (testimony of Joseph Henchman), https://goo.gl/wBohQM ("Does shipping in a returnable container versus a common carrier create nexus? Does placing an internet browser cookie on someone's computer create nexus in that someone's state? Does downloading an app in a hub airport while waiting between two interstate flights create nexus in the state of that hub airport? Once established, how long does nexus last? It is not just that we have different answers for different states, but also that many states supply vague or indeterminate non-answers to many of these questions.").

As a result, states are creating the scenario that the Commerce Clause sought to avoid: the voice for sound tax policy, for levying taxes only from those in-

state businesses and residents who benefit from provided services, is overridden by those seeking to use the state tax code to benefit in-state people and businesses. *Cf.* JAMES MADISON, THE FEDERALIST NO. 42 ("[T]he mild voice of reason, pleading the cause of an enlarged and permanent interest, is but too often drowned before public bodies as well as individuals, by the clamours of impatient avidity for immediate and immoderate gain."). This Court's guidance is needed before the states subject interstate commerce to death by a thousand cuts.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court reverse the decision of the Court below and uphold the South Dakota statute, but also resolve an almost universal lack of clarity about the proper scope of state sales taxation of out-of-state entities.

Respectfully submitted,

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